83-1118

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No. 83-

In the

Supreme Court of the United States

October Term, 1983

Winthrop P. Rockefeller, *Petitioner*,

v.

United States of America, *Respondent*.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE EIGHTH CIRCUIT

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QUESTIONS PRESENTED

1. Whether 26 U.S.C. § 4941 is a valid tax measure or an unconstitutional attempt by Congress to directly control the activities of private charitable trusts and foundations, matters reserved to the states by the Tenth Amendment to the Constitution of the United States?

2. Assuming the answer to Question No. 1 is that 26 U.S.C. § 4941 is a valid tax measure, whether Treas. Reg. § 53.4941 (d)-1(b) (3) (1971) is unconstitutional because it (1) expands 26 U.S.C. § 4941 into an area outside of congressional intent and (2) attempts to control the administration of estates of decedents, a matter reserved to the states by the Tenth Amendment to the Constitution of the United States?

TABLE OF CONTENTS

Page

Opinions below 1

Jurisdiction 1

Constitution, statute and regulations 2

Statement of the case 3

Reasons for granting the petition 5

Conclusion 15

Appendix A 1a

Appendix B 3a

Appendix C 17a

TABLE OF AUTHORITIES

Cases:

Bailey v. Drexel Furniture Co. (*Child Labor Tax Case*), 259 U.S. 20 (1922) 4–7, 15

Commissioner of Internal Revenue v. Acker, 361 U.S. 87 (1959) 9, 11

E.E.O.C. v. Wyoming, ____ U.S. ____, 103 S. Ct. 1054 (1983) 5

Estate of Hanna v. Commissioner of Internal Revenue, 320 F.2d 54 (6th Cir. 1963) 10

Gould v. Gould, 245 U.S. 151 (1917) 9, 11

Manhattan General Equipment Co. v. Commissioner, 297 U.S. 129 (1936) 9, 11

United States v. Kahriger, 345 U.S. 22 (1953) 6, 8

Yonley v. Lavender, 21 Wall. 276 (U.S. 1874) 11

Constitution, statute and regulations:

United States Constitution:

Article I, Section 8, clause 1 ..... 2, 15
Tenth Amendment ..... i, 2, 4-7, 11-15

United States Code:

Title 26 (Internal Revenue Code of 1954):

§ 507 2
§ 507 (d)(2) 12, 13
§ 4941 ..... i, 2, 4-12
§ 4941(a)(1) 3, 4
§ 4941(e)(3) 8
§ 4946 ..... 2-4, 7, 12, 14
§ 4946(a)(1)(G) 14
§ 4946(a)(2) 13
§ 4946(d) 13
§ 4947 10
§ 4947(a)(1) 7, 10
§ 6601 4
§ 7701(a)(1) 13

Title 28:

§ 1254(1) 1
§ 1291 4
§ 1346(a)(1) 3

Treasury Regulations (1954 Code) (26 C.F.R.):

§ 53.4941(d)-1(b)(3) ..... i, 2-4, 9, 11

Miscellaneous:

Committee Reports:

H. Rep. No. 91-413, 91st Cong., 1st Sess. (1969) 13
S. Rep. No. 91-552, 91st Cong., 1st Sess. (1969) 7, 9, 13
Conf. Rep. No. 91-782, 91st Cong., 1st Sess. (1969) 14

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Winthrop P. Rockefeller, *Petitioner*,

v.

United States of America, *Respondent*.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE EIGHTH CIRCUIT

The petitioner, Winthrop P. Rockefeller, petitions for a writ of certiorari to review the judgment of the United States Court of Appeals for the Eighth Circuit in this case.

OPINIONS BELOW

The opinion of the court of appeals (App. A, *infra*, 1a -2a) is reported at 718 F.2d 290 (8th Cir. 1983). The opinion and judgment of the district court (App. B, *infra*, 3a - 16a) are not reported.

JURISDICTION

The judgment of the court of appeals was entered on October 11, 1983. The jurisdiction of this Court is invoked under 28 U.S.C. § 1254(1).

CONSTITUTIONAL, STATUTORY AND REGULATORY PROVISIONS INVOLVED

Article I, section 8, clause 1, of the Constitution of the United States provides:

> The congress shall have power to lay and collect taxes, duties, imposts and excises, to pay the debts and provide for the common defense and general welfare of the United States; but all duties, imposts and excises shall be uniform throughout the United States.

The Tenth Amendment to the Constitution of the United States provides:

> The powers not delegated to the United States by the Constitution, nor prohibited by it to the states, are reserved to the states respectively, or to the people.

The relevant provisions of sections 507, 4941 and 4946 of the Internal Revenue Code of 1954 (26 U.S.C.) and of Treas. Reg. § 53.4941(d)-1(b)(3) (1971) are set forth at Appendix C, *infra*, 17a - 36a.

STATEMENT OF THE CASE

1. On February 22, 1973, Winthrop Rockefeller (petitioner's father) died. His Last Will and Testament dated November 14, 1972, left the residue of his estate to a charitable trust (the "Trust") created in his Will (App. B, *infra*, 3a).

On September 30, 1975, petitioner and the independent executors of the estate of Winthrop Rockefeller (the "Estate") entered into an Agreement wherein petitioner agreed to purchase all of the stock of Winrock Farms, Inc. ("Winrock") at its appraised fair market value. An independent appraisal of the value of the Winrock stock was then obtained. After the appraisal was completed, the executors petitioned the Probate Court of Conway County, Arkansas, (the probate court having jurisdiction over the proceedings of the estate) for approval of the sale, and an Order of the probate court was entered approving the sale at the appraised fair market value. The petitioner purchased the stock in Winrock at that appraised value on December 19, 1975 (App. B, *infra*, 4a).

Following an examination of the information return of the Trust for its fiscal year ended June 30, 1976, the Internal Revenue Service on October 10, 1979 mailed petitioner a "30-day letter" which proposed deficiencies under I.R.C. § 4941(a)(1). The Internal Revenue Service determined that petitioner was a disqualified person as defined in I.R.C. § 4946; that petitioner had paid less than the fair market value for the Winrock stock; and that the sale failed to meet all of the requirements of Treas. Reg. § 53.4941(d)-1(b)(3) and therefore was an indirect act of self-dealing (App. B, *infra*, 4a - 5a).

The petitioner paid deficiencies in December 1980 and May 1981 and thereafter timely filed claims for refund. After the disallowance of his claims, petitioner commenced this refund suit (App. B, *infra*, 5a - 6a). Jurisdiction was conferred upon the district court by 28 U.S.C. § 1346(a)(1).

2. The parties entered into a stipulation of fact and agreed to submit the case to the district court on the following issues: (1) whether I.R.C. § 4941 is constitutional; (2) whether Treas. Reg. § 53.4941(d)-1(b)(3) is constitutional; (3) whether petitioner is a disqualified person under I.R.C. §§4941 and 4946; and (4) whether the exactions paid by petitioner pursuant to I.R.C. § 4941(a)(1) are penalties, not taxes, for the purpose of computing interest on the exactions (App. B, *infra*, 3a). The district court answered yes to all four questions.

The district court held that I.R.C. § 4941 is constitutional rejecting petitioner's argument that I.R.C. § 4941 is not a tax measure but, rather, an attempt by Congress to regulate the activities of charitable trusts and foundations -a matter reserved to the states by the Tenth Amendment to the Constitution of the United States (App. B, *infra*, 7a - 8a). The district court stated that this Court has abandoned its holding in *Bailey v. Drexel Furniture Co.* (*Child Labor Tax Case*), 259 U.S. 20 (1922), and that "tax statutes are constitutional unless they contain provisions which are extraneous to any tax need" (App. B, *infra*, 8a). In upholding its validity, the district court opined that Treas. Reg. § 53.4941(d)-1(b)(3) is consistent with the intent of Congress (App. B, *infra*, 8a -12a). The district court also found petitioner to be a "disqualified person" with respect to the Trust (App. B, *infra*, 14a). Finally, the district court held that the amounts imposed on petitioner under I.R.C. § 4941(a)(1) are in the nature of penalties and, as such, the Internal Revenue Service erroneously collected interest under I.R.C. § 6601 from petitioner (App. B, *infra*, 15a).

3. In a *per curiam* opinion, the Court of Appeals for the Eighth Circuit affirmed the district court's opinion and judgment (App. A, *infra*, 2a). Jurisdiction was conferred on the circuit court by 28 U.S.C. § 1291.

REASONS FOR GRANTING THE PETITION

1. In 1969 Congress ignored the Tenth Amendment and the principles set forth by this Court in the *Child Labor Tax Case* and enacted I.R.C. § 4941. This section regulates all aspects of private charitable trusts and foundations in great detail and assesses a penalty disguised as a tax for any deviation. Without considering the limitations imposed on Congress by the Tenth Amendment, the courts below decided that the constitutional principles of the *Child Labor Tax Case* are no longer valid. They have joined the ranks of a group who believe that the Tenth Amendment has been repealed and the power of Congress to regulate all facets of our democracy is therefore unlimited.

The Tenth Amendment has not been repealed. *E.E.O.C. v. Wyoming*, ___ U.S. ___, 103 S. Ct. 1054, 1072 (1983) (Burger, C. J., dissenting). The petitioner respectfully submits that it is long past time to dust off the Federalist Papers and examine the intent of the Framers regarding the powers delegated to Congress and those retained by the states. James Madison, "the Father of the Constitution," explained that intent as follows:

> The powers delegated by the proposed Constitution to the Federal Government, are few and defined. Those which are to remain in the State Governments are numerous and indefinite. The former will be exercised principally on external objects, as war, peace, negotiation, and foreign commerce . . . . The powers reserved to the several States will extend to all the objects, which, in the ordinary course of affairs, concern the lives, liberties and properties of the people; and the internal order, improvement, and prosperity of the State. The Federalist No. 45, p. 313 (J. Cooke ed. 1961) *E.E.O.C. v. Wyoming*, ___ U.S. ___, 103 S. Ct. 1054, 1078 (1983) (Powell, J., dissenting.)

This Court should grant review to insure that established principles of constitutional restraint are honored and that the express intent of the Framers is not abandoned in 1984.

The opinions below summarily rejected the principles of the *Child Labor Tax Case* (App. B, *infra*, 7a) with these words:

> In early decisions which analyzed the constitutionality of tax statutes, the Court often drew distinctions between regulatory and revenue raising taxes. See, *Bailey v. Drexel Furniture Co.* (*Child Labor Tax Case*), 259 U.S. 20 (1922); . . . . However, the Court has subsequently abandoned such distinctions.

The opinions below believed that the "present posture" of this Court is "tax statutes are constitutional unless they contain provisions which are extraneous to any tax need. *United States v. Kahriger*, 345 U.S. 31 (1953)" (App. B, *infra*, 8a).

Although this Court has distinguished the *Child Labor Tax Case* in the last sixty years, it has neither overruled nor modified the strong, underlying bedrock of constitutional principles of that case. Moreover, in the same paragraph in *Kahriger* from which the opinions below extracted the "present posture" of this Court, the *Child Labor Tax Case* was cited as authority for the principle that:

> Penalty provisions in tax statutes added for breach of a regulation concerning activities in themselves subject only to state regulation have caused this Court to declare the enactments invalid. *United States v. Kahriger*, 345 U.S. 22, 31 (1953).

This Court would not have so cited the *Child Labor Tax Case* for that proposition if it had abandoned its principles. Because the *Child Labor Tax Case* is still good law, I.R.C. § 4941 must pass constitutional scrutiny under its principles. When the provisions of I.R.C. § 4941 are compared with those principles, the answer is clear and compelling that the section must give way to the Tenth Amendment.

I.R.C. § 4941 imposes a penalty on transactions between a disqualified person and a private foundation. The

penalty is imposed on the participating disqualified person and is 5% of the amount involved for each year (or part thereof) in the taxable period. If the transaction is not undone, a penalty equal to 200% of the amount involved is imposed on the participating disqualified person. A disqualified person for the purpose of I.R.C. § 4941 is defined in I.R.C. § 4946 and includes an individual who is (A) a substantial contributor to the private foundation, (B) a foundation manager, (C) an owner of more than a 20% interest in an entity which is a substantial contributor, or (D) a member of the family of an individual described in (A), (B) or (C) (App. C, *infra*, 30a - 33a). The Trust is treated like a private foundation pursuant to I.R.C. § 4947(a)(1).

By imposing what it termed "the highest fiduciary standards," Congress sought to control the internal affairs of private foundations through I.R.C. § 4941 because it believed that adequate safeguards did not exist under local law and administration. *S. Rep. No.* 91-552, 91st Cong., 1st Sess. 30, *Reprinted in* 1969 U.S. Code Cong. & Ad. News 2027, 2056. Its motive for regulation in the *Child Labor Tax Case* was similarly based.

The regulation of charities, its fiduciaries and charitable estates has traditionally been governed by state law and state equity and probate courts. Even though Congress sought to remedy abuses to charities, this motive, however noble, cannot, effectively, convert an Act of Congress into an amendment to the Constitution. *Child Labor Tax Case*, *supra*, at 37. Yet, this is exactly what will occur unless this intrusion is checked by this Court. This Court should grant review to preserve the integrity of the Tenth Amendment. Unless review is granted, the fears expressed by Mr. Chief Justice Taft in the *Child Labor Tax Case*, *supra*, at 38, become reality:

> Grant the validity of this law, and all that Congress would need to do, hereafter, in seeking to take over to its control any one of the great number of subjects of

public interest, jurisdiction of which the States have never parted with, and which are reserved to them by the Tenth Amendment, would be to enact a detailed measure of complete regulation of the subject and enforce it by a so-called tax upon departures from it. To give such magic to the word "tax" would be to break down all constitutional limitation of the powers of Congress and completely wipe out the sovereignty of the States.

2. The opinions below concluded that I.R.C. § 4941 served a tax need and that it was therefore constitutional under the standards in *United States v. Kahriger*, *supra* (App. B, *infra*, 8a). In *Kahriger*, this Court concluded that the provisions of the legislation at issue produced revenue, were adapted to the collection of a valid tax and, more importantly, were only *indirectly* regulatory. This case is clearly distinguishable.

There is no legislative indication nor can such an indication be drawn from its literal language that I.R.C. § 4941 was ever intended to be a revenue producing section. Nor is it adapted to the collection of a tax. Since no revenue is ever collected under the section unless its provisions are violated, it is clear that both the purpose and the application of I.R.C. § 4941 is to regulate conduct instead of taxing it.

The "tax need" found by the courts below is not stated in the congressional committee reports and simply does not exist. Further proof of its regulatory scheme is that I.R.C. § 4941(e)(3) requires the parties to undo the transaction to avoid the imposition of a 200% penalty. The *direct* purpose of I.R.C. § 4941 was intended to be regulatory and punitive. All of its provisions are designed to prohibit certain transactions between private charitable entities and those who control them and are clearly extraneous to any tax need. Clearly, Congress has exceeded its constitutional authority in enacting I.R.C. § 4941.

3. The imposition of the penalty on petitioner is invalid even if I.R.C. § 4941 could withstand constitutional scrutiny. The determinations and regulation of the Internal Revenue Service unconstitutionally expand I.R.C. § 4941 beyond the congressional intent to control transactions between private foundations and disqualified persons. These determinations and regulation expand the congressional intent (1) to control the activities of estates in probate administration and (2) to include a decedent as a disqualified person.

These are important issues of first impression dealing with the very premises on which our federalistic form of government has flourished. There is no conflict in the circuits, but the opinions below are in direct conflict with principles set forth in decisions of this Court. The issues present substantial questions of federal law which are of significant national importance.

a. Since it failed to meet all of the requirements of Treas. Reg. § 53.4941(d)-1(b)(3) (App. C, *infra*, 34a - 36a), the sale was considered by the Internal Revenue Service to be an "indirect" act of self-dealing, and petitioner was penalized. In holding that this regulation is valid, the opinions below incorrectly applied this Court's rules of statutory construction by broadly construing a penalty statute to apply to an area not clearly covered, *see, Commissioner of Internal Revenue v. Acker*, 361 U.S. 87 (1959); *Gould v. Gould*, 245 U.S. 151 (1917); and thereby gave judicial approval to the unconstitutional exercise of legislative powers by an administrative agency of the executive branch of the government. *Manhattan General Equipment Co. v. Commissioner*, 297 U.S. 129 (1936).

In enacting I.R.C. § 4941 Congress was concerned "that even arm's-length standards often permit use of a private foundation to improperly benefit *those who control* the foundation." *S. Rep. No.* 91-552, 91st Cong., 1st Sess. 28, 29, *Reprinted in* 1969 U.S. Code Cong. & Ad. News 2027, 2055

(Emphasis supplied.). Since a decedent, obviously, cannot possibly be one in control, it does not follow, as the courts below concluded, that "Congress would be concerned about the circumvention of an estate's assets which are earmarked for a private foundation" or that it is "reasonable to subject such an estate, in part, to statutory checks which Congress has deemed fit for private foundations" (App. B, *infra*, 10a). There simply is no evidence in the legislative history of I.R.C. § 4941 that Congress was concerned about transactions with estates.

Unlike private foundations—whether trusts or corporations—*estates are created involuntarily.* Thus, they are inherently protected from the abuses I.R.C. § 4941 seeks to cure. Multiple and sufficient controls exist independently of I.R.C. § 4941 to insure that the special status of an estate is protected. Executors are charged with the highest of fiduciary standards, the violation of which imposes personal liability. Executors obtain their legal authority from courts with probate jurisdiction and their actions are subject to judicial review and control by the state probate court or courts having jurisdiction over the affairs of the decedent's estate. Their letters of administration make them officers of the probate court, and they are directly responsible to that court. Executors must obtain advance approval of the probate court prior to consummating many transactions and must strictly account to the court for their actions.

Had Congress been concerned about assets of an estate that are earmarked for a private foundation and desired to subject such an estate, in part, to statutory checks, it would have had a clear avenue in I.R.C. § 4947 to apply the private foundation sanctions to estates with charitable interests, just as I.R.C. § 4947(a)(1) applies to the Trust. Congress could have simply inserted the words "or an estate" after the word "trust" in I.R.C. § 4947. *See, Estate of Hanna v. Commissioner of Internal Revenue*, 320 F. 2d 54, 57 (6th Cir. 1963). Since it did not do so, the Internal Revenue Service has no justification for enlarging I.R.C. § 4941 by implica-

tion and penalizing taxpayers not *clearly* covered by it. *Commissioner of Internal Revenue v. Acker, supra; Manhattan General Equipment Co. v. Commissioner, supra;* and *Gould v. Gould, supra.*

It is reasonable to conclude in light of the foregoing that Congress recognized that an estate of a deceased person cannot be a device created to circumvent I.R.C. § 4941. Yet this recognition by Congress has been ignored and rejected by the Internal Revenue Service. Treas. Reg. § 53.4941(d)-1(b)(3) is an erroneous interpretation of a non-ambiguous statute. The regulation arbitrarily expands the scope of the statute and does not follow the *clear* intent of the statute. It should be found to be a nullity since it operates to create a rule out of harmony with the statute. *Manhattan General Equipment Co. v. Commissioner, supra.*

The regulation is also unconstitutional because under the threat of federal penalties for doing otherwise it forces estates, trusts and disqualified persons described therein to conduct the affairs of, or dealings with, estates or trusts in conformity with federally imposed standards. Apparently uncomfortable with the integrity of the probate courts of the states, the Internal Revenue Service through the regulation has usurped the role of and placed itself above the states' probate courts in a second-guessing role as judge of activities within probate administration.

The jurisdiction over the descent, distribution, and administration of decedents' estates was reserved to the several states by the Tenth Amendment. As this Court said in *Yonley v. Lavender*, 21 Wall. 276, 279 (U.S. 1874), with respect to Arkansas probate law—

> *The several States of the Union necessarily have full control over the estates of deceased persons* within their respective limits . . . . It is easy to see, if the non-resident creditor, by suing in the Federal courts of Arkansas, acquires a right to subject the assets of the

> estate to seizure and sale for the satisfaction of his debt, which he could not do by suing in the State court, that the whole estate, in case there were foreign creditors, might be swept away. *Such a result would place the judgments of the Federal court on a higher grade than the judgments of the State court, necessarily produce conflict, and render the State powerless in a matter over which she has confessedly full control.* (Emphasis supplied.)

Congress cannot legislate the conduct of estates in administration, and its restraint in applying I.R.C. § 4941 to estates may well have contemplated this overriding state power. The attempt by the Internal Revenue Service by its regulation to apply I.R.C. § 4941 to the administration of an estate is an unconstitutional invasion of the rights of the states.

b. The opinions below agreed with the determination by the Internal Revenue Service that petitioner is a disqualified person since he is "a member of the family, i.e., a lineal descendant, of a substantial contributor to the trust" (App. B, *infra*, 14a). The reasoning leading to this holding was that because of the cross-reference to I.R.C. § 507(d)(2) in I.R.C. § 4946, Winthrop Rockefeller, although deceased, is a currently existing substantial contributor to the Trust under I.R.C. § 4946 and that petitioner is, as a member of the family of a substantial contributor, to be treated as a disqualified person (App. B, *infra*, 14a). This interpretation of I.R.C. § 4946 reaches an unreasonable and unsound result which goes far beyond the intent of Congress and, therefore, is an unconstitutional exercise of legislative powers.

As noted above, Congress was concerned with dealings between a private foundation and those who control the foundation. Consistent with this intent, Congress enacted I.R.C. § 4946 which defines a disqualified person mainly for the purpose of controlling his or her relationship with a private foundation.

A disqualified person for the purpose of the self-dealing provisions is a person *who is* (A) a substantial contributor to the foundation, (B) a foundation manager, (C) an owner of more than a 20% interest in an entity which is a substantial contributor, or (D) a member of the family of any of the three above. It also includes a corporation, partnership, trust, or estate in which any one or more of the persons described in (A), (B), (C), or (D) has a 35% interest. A substantial contributor is defined in I.R.C. § 4946(a)(2) as "a person who is described in section 507(d)(2)" (App. C, *infra*, 30a-33a).

The reference in I.R.C. § 4946(a)(2) to "a person *who is* described in section 507(d)(2)" cannot refer to a decedent because the definition of a "person" in the Internal Revenue Code does not include a decedent. I.R.C. § 7701(a)(1) defines a person, *inter alia*, as including an individual, estate, or trust. It does not include decedents, who are in fact represented by their estates.

When the Tax Reform Act of 1969 passed the House of Representatives, the attribution of disqualified person status to a family member was accomplished by a series of cross references to the personal holding company and collapsible corporations rules contained in the Internal Revenue Code. *See, H. Rep. No.* 91-413, 91st Cong., 1st Sess. 21, 22, *Reprinted in* 1969 U.S. Code Cong. & Ad. News 1663, 1666. The Senate eliminated these cross references for the stated purpose of limiting attribution of disqualified person status. Instead, it spelled out the definition of family membership in I.R.C. § 4946(d) and gave the reason that:

> The committee was especially concerned that the rules be reasonable as to who are substantial contributors and related persons because the foundation will need to keep the records to identify those who are disqualified from dealing with it. *S. Rep. No.* 91-552, 91st Cong., 1st Sess. 30, *Reprinted in* 1969 U.S. Code Cong. & Ad. News 2027, 2057.

The Committee on Conference accepted this restriction. *Conf. Rep. No.* 91-782, 91st Cong., 1st Sess. 279, *Reprinted in* 1969 U.S. Code Cong. & Ad. News 2392, 2393.

In light of the fact that Congress was concerned with "those who control" and in view of the specific coverage in I.R.C. § 4946(a)(1)(G) of attribution where estates and trusts are involved, the only reasonable way to look at I.R.C. § 4946 is to think of it as referring to a living individual or an existing entity - a person "who is." If it is extended beyond living persons in either direction, there is no indicated stopping place; the results are absurd if the dead and the unborn must be taken into account. Such a position would be clearly contrary to the Senate's view of the matter and the unconstitutional exercise of legislative powers.

CONCLUSION

The opinions below hold that Congress can directly control under its general taxing power a matter reserved to the states by the Tenth Amendment by simply cloaking its legislation with cellophane labeled "An excise tax. U.S. Const. art. I, § 8, cl. 1." This is in direct conflict with this Court's holding in the *Child Labor Tax Case, supra.* This Court must exercise its constitutional role as final arbiter and decide whether Congress may substitute its judgment for that of the states. The petition for a writ of certiorari must be granted, and the lower court opinions reversed. Otherwise, Congress and the courts will continue to ignore the Tenth Amendment and the words of Mr. Chief Justice Taft:

> To give such magic to the word "tax" would be to break down all constitutional limitation of the powers of Congress and completely wipe out the sovereignty of the States. *Child Labor Tax Case, supra,* at 38.

Respectfully submitted,

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January, 1984.

APPENDIX

APPENDIX A

UNITED STATES COURT OF APPEALS
FOR THE EIGHTH CIRCUIT

Nos. 83-1192 and 83-1281

Winthrop P. Rockefeller,	*	
	*	
Appellant/Cross Appellee,	*	
	*	
v.	*	Appeals from the United
	*	States District Court for
	*	the Eastern District
United States of America,	*	of Arkansas
	*	
Appellee/Cross Appellant.	*	

Submitted: September 12, 1983

Filed: October 11, 1983

Before HEANEY, ROSS and JOHN R. GIBSON, Circuit Judges.

PER CURIAM.

Winthrop P. Rockefeller brought this action for the recovery of penalties assessed by the Internal Revenue Service (IRS) under 26 U.S.C. § 4941. In 1975, Rockefeller purchased all of the stock of Winrock Farms, Inc. from the estate of his father. In 1979, the IRS determined that the purchase was an indirect act of self-dealing between Rockefeller and a charitable trust created in his father's will in violation of section 4941. Rockefeller paid the penalties and interest assessed by the IRS and instituted this action to recover those amounts.

In the district court, Rockefeller asserted that section 4941 was not applicable to the purchase because it and Treasury Regulation § 53.4941 (d)-1 (b) (3) were unconstitutional; the regulation was not a valid interpretation of section 4941; he is not a "disqualified person" with respect to the charitable trust; and the IRS may not assess and collect interest on the amounts imposed under section 4941.

Initially, the district court found that section 4941 is constitutional. The court noted that section 4941 was enacted to prevent various abuses surrounding tax-exempt organizations. Secondly, the court upheld the validity of Treasury Regulation § 53.4941 (d)-1 (b) (3) finding that it was reasonable and consistent with the intent of Congress. The court also found that Rockefeller was a "disqualified person" with respect to the trust as that phrase is defined in section 4946. The court found that the tax imposed by section 4941 (a) (1) is in the nature of a penalty and, as such, no interest may accrue on the unpaid tax liability.

We have carefully studied the record, including the district court's opinion, the briefs and the arguments of the parties to this action. We do not agree with appellant's arguments, and accordingly affirm pursuant to Rule 14 of the Rules of this court on the basis of Judge Overton's opinion.

A true copy.

Attest:

CLERK, U.S. COURT OF APPEALS, EIGHTH CIRCUIT.

APPENDIX B

IN THE UNITED STATES DISTRICT COURT
EASTERN DISTRICT OF ARKANSAS
WESTERN DIVISION

WINTHROP P. ROCKEFELLER — PLAINTIFF

VS. — NO. LR C 81 775

UNITED STATES OF AMERICA — DEFENDANT

ORDER

This is an action for the recovery of taxes and interest assessed against and paid by the plaintiff pursuant to 26 U.S.C. § 4941 (a) (1). The parties have entered into a stipulation of fact and have agreed to present the case to the Court on the following issues: (1) whether 26 U.S.C. § 4941 is constitutional; (2) whether Treas. Reg. Sec. 53-4941 (d)-1 (b) (3) is constitutional; (3) whether plaintiff is a disqualified person under § 4941; and (4) whether the exactions assessed against the plaintiff pursuant to § 4941 (a) (1) are penalties, not taxes, for the purpose of computing interest on the exactions. The parties also submitted the issue of whether plaintiff is entitled to attorney's fees to the Court; however, they have subsequently agreed that plaintiff is not entitled to those fees. The Court concurs.

Background Facts

On February 22, 1973, Winthrop Rockefeller died. Pursuant to the terms of his Last Will and Testament, dated November 14, 1972, he left the residue of his estate to a charitable trust created under his Will. The Will contemplated that certain properties known as Winrock Farms would constitute a substantial part of the residue and would compose a substantial part of the trust.

On September 30, 1975, plaintiff, the son of Winthrop Rockefeller, and the executor of the estate of Winthrop Rockefeller, entered into an agreement wherein plaintiff agreed to purchase all of the stock of Winrock Farms. The plaintiff and the estate obtained an independent appraisal of the fair market value of the Winrock Farms' stock, and petitioned the Probate Court of Conway County, Arkansas, (the probate court having jurisdiction over the proceedings of the estate), for approval of the sale. The Probate Court entered an order approving the sale at the appraised fair market value, and plaintiff purchased the stock at that value on December 19, 1975.

After auditing the estate's 1975 tax return, the Internal Revenue Service issued a report which proposed certain adjustments in the estate's tax return. The proposed adjustments were based on certain findings of fact, one of which was that the sale of the stock to the plaintiff was not at fair market value. The Regional Office of Appeals of Service, in Oklahoma City, Oklahoma, rejected this proposed finding of fact and adjustment and recommended that the sale of stock be examined as a possible violation of 26 U.S.C. § 4941.

After conducting an investigation of the Estate's 1976 tax return and the information return of the Trust u/w Winthrop Rockefeller, on October 10, 1979, the IRS mailed plaintiff a "30 day letter" which proposed deficiencies under § 4941 (a)(1). Section 4941(a)(1) imposes a "tax" on each act of self dealing between a disqualified person and a private foundation. The Commissioner of the IRS determined that the trust was a private foundation, that plaintiff was a disqualified person with respect to the trust and that plaintiff's purchase of the Winrock Farms' stock was an act of indirect self dealing between plaintiff and the trust. In determining that transactions between the plaintiff and the estate constituted an act of self dealing, the Commissioner relied on the definition of self dealing in § 4941(a)(1), which includes indirect sales between a disqualified person and a private

foundation, and Treas. Reg. §53.4941(d)-1(b)(3). That Treasury Regulation covers transactions during the administration of an estate or revocable trust. It provides in relevant part that the term "indirect self dealing" does not include a transaction with respect to a private foundation's interest or expectancy in property held by an estate, regardless of when title vests under local law, as long as the following criteria are met: (1) the administrator or executor of an estate must have the power to sell or reallocate the property in question, if it is subject to an option, (2) the transaction must have been approved by the probate court or by another court having jurisdiction over the property, (3) the transaction must occur before the estate is considered terminated for federal income tax purposes, (4) the estate must receive an amount which equals or exceeds the fair market value of the foundation's interest or expectancy in such property at the time of the transaction, and (5) the transaction must result in the foundation receiving an interest or expectancy at least as liquid as the one it gave up. The IRS Commissioner found that plaintiff had not paid the estate the fair market value of the property and, thus, had engaged in an act of indirect self dealing with the trust.

On December 10, 1979, the plaintiff timely filed a protest contesting the proposed deficiencies. Almost one year later, after several conferences with an appeals officer in the IRS's office of the Regional Director of Appeals, plaintiff and the Commissioner of Internal Revenue executed Form 906, Closing Agreement on Final Determination Covering Specific Matters. Pursuant to the terms of the closing agreement, plaintiff and the Commissioner conceded that the fair value of the Winrock Farms' stock was greater than the amount paid to the estate, but less than the amount proposed in the IRS's 30 day letter. The plaintiff also agreed to pay the IRS $2,067,558.95, which encompassed $341,865 in taxes imposed by the IRS under 26 U.S.C. § 4941(a)(1) for each of the calendar years of 1975 through 1980, plus $358,233.95 in interest. However, plaintiff reserved the right to recover these amounts in litigation. The plaintiff

and the Commissioner agreed to limit the bases for any such litigation to the validity and/or applicability of 26 U.S.C. § 4941 and the regulations promulgated thereunder, and the question of whether the amount imposed by § 4941(a)(1) is a penalty in which the Service may not assess and collect any interest under 26 U.S.C. § 6601 if that amount is not paid within 10 days of notice and demand for payment of Service.

In December of 1980, plaintiff mailed the IRS a check for the total amount allegedly owed through calendar year 1979. In May, 1981, he sent the IRS a check for the amount assessed against him for the calendar year 1980. In the Spring of 1981, plaintiff filed claims for refund with the IRS for the years 1975 through 1980, inclusive, which were denied on September 30, 1981. Plaintiff filed suit on November 5, 1981.

I. 26 U.S.C. § 4941 is a constitutional exercise of congressional taxing power.

Section 4941 is a part of the Tax Reform Act of 1969 and is an amendment to a piece of tax legislation which exempts certain organizations from taxation. Section 4941 imposes a "tax" on each act of self dealing between a disqualified person and a private foundation. The "tax" is assessed against the participating disqualified person (the self dealer) and is 5% of the amount involved, with respect to the act of self dealing for each year (or part thereof) in the taxable period. If the act of self dealing is not corrected, a penalty equal to 200% of the amount involved is imposed on the self dealer.

Prior to the Tax Reform Act of 1969, 26 U.S.C. § 503 imposed arm's length standards to certain types of self dealing between organizations described in § 501(c)(3), which includes what is now defined as private foundations, and certain individuals. The remedies available to the Internal Revenue Service upon violation of § 503 were revocation of the organization's tax exempt status for a minimum of one

taxable year, and denial of the donor's charitable contribution deduction. See, 26 U.S.C. § 504 (Repealed 1969). However, Congress observed that there were many abuses in the enforcement and utilization of § 503. In order to minimize the need to apply subjective standards, to avoid the temptation to use private foundations for noncharitable purposes, to provide a rational relationship between sanctions and improper acts and to make it more practical to enforce the law, Congress enacted 26 U.S.C. § 4941. S. Rep. No. 91-552, 91st Cong., 1st Sess. 28, *Reprinted in* 1969 U.S. Code Cong. & Ad. News 1663, 1665.

Plaintiff contends that § 4941 is an unconstitutional extension of congressional taxing power under Art. 1, § 8, Clause 1 of the United States Constitution. He specifically contends that the purpose of § 4941 is not to raise revenue, but to regulate private foundations by imposing penalties on individuals who use them for noncharitable purposes. He also asserts that § 4941 is an arrogation of the State of Arkansas' right to regulate charities, which was reserved to the state by the Tenth Amendment to the United States Constitution.

In early decisions which analyzed the constitutionality of tax statutes, the Court often drew distinctions between regulatory and revenue raising taxes. See, *Bailey v. Drexel Furniture Co. (Child Labor Tax Case)*, 259 U.S. 20 (1922); *Hill v. Wallace*, 259 U.S. 44 (1922); and *Helmig v. United States*, 188 U.S. 605 (1903). However, the Court has subsequently abandoned such distinctions. In its brief opinion in *United States v. Sanchez*, 340 U.S. 42, 44-45 (1950), the Court stated:

> It is beyond serious question that a tax does not cease to be valid merely because it regulates, discourages, or definitely deters the activity taxed. *Sanzinsky v. United States*, 300 U.S. 506, 513-514 (1937). The principle applies even though the revenue obtained is obviously negligible, *Sanzinsky v. United*

> *States, supra*, or the revenue purpose of tax may be secondary. *Hampton & Co. v. United States*, 376 U.S. 394 (1928). Nor does a tax statute necessarily fall because it touches on activities which Congress may not otherwise regulate . . . .

Under the present posture of the law, tax statutes are constitutional unless they contain provisions which are extraneous to any tax need. *United States v. Kahriger*, 345 U.S. 31 (1953).

It is clear that § 4941 is constitutional as measured by the standards set forth in *Kahriger*. Congress has seen fit, in enacting the internal revenue laws, to grant tax exempt status to certain entities. Additionally, Congress has allowed individuals, corporations and estates the right to escape taxation of the amounts donated for charitable purposes. 26 U.S.C. §§ 170, 642(c), 2055 and 2522. However, when Congress observed that its legislative grace was being abused, it enacted § 4941 to insure that its original intent in granting non-taxable status was complied with. Although § 4941 has a regulatory effect on the activities of charitable organizations and might not raise any revenue, it insures that revenue will be collected under income, estate, and gift tax laws which otherwise might have gone uncollected.

II. Treas. Reg. Sec. 53.4941(d)-1(b)(3) is constitutional.

Plaintiff's next contention is that even if Section 4941 is constitutional, Treas. Reg. Sec. 53.4941(d)-1(b)(3), which interprets that section of the Internal Revenue Code, is unconstitutional. Plaintiff asserts that there are three constitutional deficiencies in Treas. Reg. Sec. 53.4941(d)-1(b)(3).

First, he alleges that the treasury regulation is an impermissible extension of § 4941 because Congress never intended for § 4941 to encompass transactions between

estates and disqualified persons. In support of his contention, plaintiff argues that the language of the statutes which are the subject matter of this litigation are completely devoid of any references to estates. He points out that § 4941(d), which defines self dealing, only refers to transactions between disqualified persons and private foundations and never mentions estates. He also points out that an estate is not a private foundation as described in § 501 (c)(3), or a charitable trust as described in § 4947. He further argues that the legislative history of § 4941 indicates that the statute was not intended to cover transactions with estates. He notes that one of the principal purposes of Congress in implementing § 4941 was to obviate the problem of equitable administration and enforcement of the arm's length standards of § 503. S. Rep. No. 91-552, 91st Cong., 1st Sess. 28, *Reprinted in* 1969 U.S. Code Cong. & Ad. News 1663, 1664. He reasons that the corrective measures of § 4941 were unnecessary with respect to estates because there are sufficient checks under the status quo which protect the property in an estate, such as estate tax laws, other legatees, devisees and creditors under the decedent's will, laws imposing personal liability upon executors and administrators for breach of their fiduciary duty, and laws requiring administrators and executors to receive advance approval from the probate court before consummating transactions with the estate.

The authority of the Secretary of Treasury to administer the internal revenue statutes and to prescribe rules and regulations to that end is beyond question. 26 U.S.C. § 7805(a). However, that power is limited to the adoption of *reasonable* regulations which will effectuate the will of Congress as expressed by the statute. *Manhattan General Equipment Co. v. Commissioner of Internal Revenue*, 124 U.S. 129 (1936). Treas. Reg. § 53.4941(d)-1(b)(3) is both consistent with 26 U.S.C. § 4941 and reasonable.

Congress had numerous objectives in enacting § 4941, and was not solely concerned with the equitable administra-

tion and enforcement of the arm's length standards of § 503. Another purpose of § 4941 was to prevent disqualified persons who were in literal compliance with § 503 from surreptitiously using private foundations for their own benefit. S. Rep. No. 91-552, 91st Cong., 1st Sess. 28, *Reprinted in* 1969 U.S. Code Cong. & Ad. News 1663, 1667. It logically follows that Congress would be concerned about the circumvention of an estate's assets which are earmarked for a private foundation, especially in a case such as this, where the bulk of the estate is bequeathed to a charitable trust. It is also reasonable to subject such an estate, in part, to the statutory checks which Congress has deemed fit for private foundations.

It should also be noted that the fact that Congress failed to mention the word estate in § 4941, or related statutes, is not determinative of the constitutionality of Treas. Reg. Sec. 53.4941(d)-1(b)(3). That regulation was promulgated to interpret the term "self dealing," which is broadly defined under § 4941(d)(1)(a) as any direct or indirect sale, exchange or lease of property between a private foundation and a disqualified person. In similar circumstances, where the Courts have been called upon to determine the constitutionality of regulations which interpret statutes which are couched in general terms, as in § 4941(d)(1)(a), courts have deferred to the regulation as long as it implements the Congressional mandate in a reasonable manner. *See, United States v. Cartwright*, 411 U.S. 546 (1973) and *National Muffler Dealers Assn. v. United States*, 440 U.S. 472 (1979). This Court defers to Treas. Reg. Sec. 53.4941(d)-1(b)(3).

Second, plaintiff alleges that Treas. Reg. Sec. 53.4941(d)-1(b)(3) is arbitrary, unreasonable and vague. He asserts that the treasury regulation is arbitrary in that it only covers sales and exchanges and excludes all other transactions. He asserts that the treasury regulation is unreasonable because it encompasses transactions in which "disqualified persons" do not intentionally manipulate the

assets of an estate, which will flow to a private foundation, for their own benefit. He also asserts that the treasury regulation's subjective requirements regarding liquidity and fair market value, and its negative statement of the definition of the term "indirect self dealing," make the regulation unconstitutionally vague.

Plaintiff's assertion that the treasury regulation is unconstitutionally arbitrary and unreasonable is without merit. The essence of plaintiff's argument is that the treasury regulation is unfair because it does not solve every problem which might arise in the estate context. The incomprehensiveness of the treasury regulation violates no constitutional mandate. Although the Court concedes that improvement might be made in the regulation, it also notes that it does not have authority to sit as a committee of revision to perfect the administration of the tax laws. Congress has delegated to the Commissioner of the Internal Revenue Service, not the courts, the task of prescribing "all needful rules and regulations for the enforcement" of the Internal Revenue Code. 26 U.S.C. § 7805(a). In this area of limitless factual variations, "it is the province of the Congress and the Commissioner, not the courts, to make the appropriate adjustments." *Commissioner v. Stedger*, 386 U.S. 287, 296 (1966). The role of the judiciary in cases of this sort begins and ends with assuring that the Commissioner's regulations fall within his authority to implement the Congressional mandate in a reasonable manner. *Manhattan General Equipment Co., v. Commissioner, supra.* The regulation has not been shown to be deficient on that score; therefore, it must be upheld.

Likewise, plaintiff's assertion that the treasury regulation is unconstitutionally vague has no merit. The test of vagueness is whether men of common intelligence must guess at its meaning. *Conally v. General Construction Co.*, 269 U.S. 385 (1925). Laws that have failed to meet this standard are, almost without exception, those which turn on language calling for the exercise of subjective judgment,

unaided by objective norms. *E.g., United States v. L. Cohen Grocery Co.*, 255 U.S. 81 ("unreasonable charges"); *Winters v. New York*, 333 U.S. 507 ("so massed as to become vehicles for inciting"); *Joseph Burstyn, Inc. v. Wilson*, 343 U.S. 495 ("sacrilegious"). No such language is found in the Treasury regulation.

Plaintiff also alleges that the treasury regulation unconstitutionally attempts to impose federal regulation of activities subject only to state regulation, i.e., probate administration. He reasons that since it is improper for Congress to legislate the conduct of estate administration, it is equally, if not more, improper for the Internal Revenue Service to attempt supervision of estates by regulation. This contention must also fail, because it is based on an erroneous premise. A tax statute is not constitutionally infirm merely because it touches on activities Congress may not otherwise regulate. *United States v. Sanchez*, 340 U.S. 42, 45 (1950). As long as a regulation is reasonable and effectuates the will of Congress as expressed by the statute, it must be sustained. *Manhattan General Equipment v. Commissioner*, 124 U.S. 129 (1936). Treas. Reg. § 53-4941 (d)-1(b)(3) meets that standard.

III. Plaintiff is a disqualified person with respect to the trust.

Section 4941 imposes a tax on each act of self dealing between a disqualified person and a private foundation. Section 4946 of the Internal Revenue Code defines the term "disqualified person" and reads, in part, as follows:

> (a) *Disqualified Person*. —
>
> (1) In general. — For purposes of this subchapter, the term "disqualified person" means, with respect to a private foundation, a person who is —

(A) a substantial contributor to the foundation

****

(D) a member of the family (as defined in subsection (d) of any individual described in subparagraph (A), (B), or (C),

(2) *Substantial contributors.* —

For purposes of paragraph (I), the term "substantial contributor" means a person who is described in Section 507(d)(2)

****

(d) *Members of Family.* — For purposes of subsection (a)(1), the family of an individual shall include only his spouse, ancestors, lineal descendants, and spouses of lineal descendants.

Section 507(d) of the Code, which is referred to in the definition of substantial contributor, provides, in part, as follows:

> For purposes of Paragraph (1), the term "substantial contributor" means the person who contributed or *bequeathed* an aggregate amount of more than $5,000.00 to the private foundation, if such amount is more than 2 percent of the total contributions and bequests received by the foundation before the close of the taxable year of the foundation in which the contribution or bequest is received by the foundation from such person. *In the case of a trust, the term substantial contributor also means the creator of the trust.* (Emphasis added.)

Plaintiff contends that he is not a disqualified person with respect to the trust because his deceased father does not fall within the definition of substantial contributor under § 4946. He alleges that since § 7701(a)(1), defines a person as an individual, estate or trust, the reference in

§ 4946(a)(2) to a "person described in § 507(d)(2)" contemplates only living persons and existing entities. Plaintiff also implies that § 507(d)(2) should not be used to define "disqualified person" because the impact of § 507(d) is to recoup the tax benefits which had accrued to the foundation and to its past substantial contributors, not to control the relationship between disqualified persons and private foundations.

The Court finds that plaintiff falls within the definition of "disqualified person". He is a member of the family, i.e., a lineal descendent, of a substantial contributor to the trust. Plaintiff's suggestion that it is inappropriate to use § 507(d)(2) to define "disqualified person" is unsupported. The face of the statute clearly indicates that Congress intended that section to apply, as written, to § 4946(a)(1) regardless of its function elsewhere in the Code. Section 507(d)(2) clearly contemplates that a decedent can be a substantial contributor since a bequest is expressly considered to be a contribution. In addition, § 507(d)(2) provides that in case of a trust, the creator is deemed a substantial contributor. There can be no doubt that plaintiff's father, although deceased, is a substantial contributor with respect to the trust within the meaning of § 4946.

IV. Section 4941(a) is a penalty for the purpose of assessing interest.

Pursuant to plaintiff's settlement agreement with the government, he paid $358,233.95 in interest which was assessed pursuant to § 6601(a) of the Internal Revenue Code. That section provides that interest shall be charged on any amount/tax from the last date prescribed for payment to the date actually paid. Plaintiff contends that he is entitled to a refund of interest because § 4941(a)(1) imposes a penalty, not a tax, and because he has complied with § 6601(e)(3) which governs interest on penalties. Section 6601(e)(3) provides that interest shall be imposed on assessable penalty only if the penalty is not paid within ten days of the issuance of notice and demand for the payment

of the assessment. It is undisputed by the parties that plaintiff paid the amounts assessed under § 4941(a) within 10 days of demand and notice.

This Court ruled that § 4941 was penalty for the purpose of assessing interest in *Farrell v. United States*, 484 F. Supp. 1097 (E.D. Ark. 1980). Defendant has advanced no new argument to persuade the Court that its decision was erroneous.

Judgment will be entered in favor of the plaintiff and against defendant for $358,133.95.

Dated December 16, 1982

/s/ William R. Overton
UNITED STATES DISTRICT JUDGE

IN THE UNITED STATES DISTRICT COURT FOR THE
EASTERN DISTRICT OF ARKANSAS
WESTERN DIVISION

WINTHROP P. ROCKEFELLER PLAINTIFF

VS. NO. LR C 81 755

UNITED STATES OF AMERICA DEFENDANT

JUDGMENT

Pursuant to the Order entered in this matter on December 16, 1982, judgment is entered for the plaintiff, Winthrop P. Rockefeller, and against the defendant, the United States of America, for $358,233.95 with interest thereon as provided by law; and plaintiff's other claims for refund totaling $2,051,190.00 are dismissed.

ORDERED this 10 day of January, 1983.

/s/ William R. Overton
UNITED STATES DISTRICT JUDGE

APPENDIX C

Internal Revenue Code of 1954 (26 U.S.C.):

SEC. 507. Termination of Private Foundation Status.

(a) General Rule — Except as provided in subsection (b), the status of any organization as a private foundation shall be terminated only if—

(1) such organization notifies the Secretary (at such time and in such manner as the Secretary may by regulations prescribe) of its intent to accomplish such termination, or

(2) (A) with respect to such organization, there have been either willful repeated acts (or failures to act), or a willful and flagrant act (or failure to act), giving rise to liability for tax under chapter 42, and

(B) the Secretary notifies such organization that, by reason of subparagraph (A), such organization is liable for the tax imposed by subsection (c),

and either such organization pays the tax imposed by subsection (c) (or any portion not abated under subsection (g)) or the entire amount of such tax is abated under subsection (g).

(b) *Special Rules* —

(1) *Transfer to, or operation as, public charity* — The status as a private foundation of any organization, with respect to which there have not been either willful repeated acts (or failures to act) or a willful and flagrant act (or failure to act) giving rise to liability for tax under chapter 42, shall be terminated if —

(A) such organization distributes all of its net assets to one or more organizations described in section 170(b)(1)(A) (other than in clauses (vii) and (viii)) each of which has been in existence and so described for a continuous period of at least 60 calendar months immediately preceding such distribution, or

(B) (i) such organization meets the requirements of paragraph (1), (2), or (3) of section 509(a) by the end of the 12-month period beginning with its first taxable year which begins after December 31, 1969, or for a continuous period of 60 calendar months beginning with the first day of any taxable year which begins after December 31, 1969,

(ii) such organization notifies the Secretary (in such manner as the Secretary may by regulations prescribe) before the commencement of such 12-month or 60-month period (or before the 90th day after the day on which regulations first prescribed under this subsection become final) that it is terminating its private foundation status, and

(iii) such organization establishes to the satisfaction of the Secretary (in such manner as the Secretary may by regulations prescribe) immediately after the expiration of such 12-month or 60-month period that such organization has complied with clause (i).

If an organization gives notice under subparagraph (B)(ii) of the commencement of a 60-month period and such organization fails to meet the requirements of paragraph (1), (2), or (3) of section 509(a) for the entire 60-month period, this part and chapter 42 shall not apply to such organization for any taxable year

within such 60-month period for which it does meet such requirements.

(2) *Transferee Foundations* — For purposes of this part, in the case of a transfer of assets of any private foundation to another private foundation pursuant to any liquidation, merger, redemption, recapitalization, or other adjustment, organization, or reorganization, the transferee foundation shall not be treated as a newly created organization.

(c) *Imposition of Tax* — There is hereby imposed on each organization which is referred to in subsection (a) a tax equal to the lower of —

(1) the amount which the private foundation substantiates by adequate record or other corroborating evidence as the aggregate tax benefit resulting from the section 501(c)(3) status of such foundation, or

(2) the value of the net assets of such foundation.

(d) *Aggregate Tax Benefit* —

(1) *In General* — For purposes of subsection (c), the aggregate tax benefit resulting from the section 501(c)(3) status of any private foundation is the sum of —

(A) the aggregate increases in tax under chapters 1, 11, and 12 (or the corresponding provisions of prior law) which would have been imposed with respect to all substantial contributors to the foundation if deductions for all contributions made by such contributors to the foundation after February 28, 1913, had been disallowed, and

(B) the aggregate increases in tax under chapter 1 (or the corresponding provisions of prior law) which would have been imposed with respect to the income of the private foundation for taxable years beginning after December 31, 1912, if (i) it had not been exempt from tax under section 501(a) (or the corresponding provisions of prior law), and (ii) in the case of a trust, deductions under section 642(c) (or the corresponding provisions of prior law) had been limited to 20 percent of the taxable income of the trust (computed without the benefit of section 642(c) but with the benefit of section 170(b)(1)(A)), and

(C) interest on the increases in tax determined under subparagraphs (A) and (B) from the first date on which each such increase would have been due and payable to the date on which the organization ceases to be a private foundation.

(2) *Substantial Contributor* —

(A) *Definition* — For purposes of paragraph (1), the term "substantial contributor" means any person who contributed or bequeathed an aggregate amount of more than $5,000.00 to the private foundation, if such amount is more than 2 percent of the total contributions and bequests received by the foundation before the close of the taxable year of the foundation in which the contribution or bequest is received by the foundation from such person. In the case of a trust, the term "substantial contributor" also means the creator of the trust.

(B) *Special Rules* — For purposes of subparagraph (A) —

(i) each contribution or bequest shall be valued at fair market value on the date it was received,

(ii) in the case of a foundation which is in existence on October 9, 1969, all contributions and bequests received on or before such date shall be treated (except for purposes of clause (i)) as if received on such date,

(iii) an individual shall be treated as making all contributions and bequests made by his spouse, and

(iv) any person who is a substantial contributor on any date shall remain a substantial contributor of all subsequent periods.

(3) *Regulations*—For purposes of this section, the determination as to whether and to what extent there would have been any increase in tax shall be made in accordance with regulations prescribed by the Secretary.

(e) *Value of Assets*—For purposes of subsection (c), the value of the net assets shall be determined at whichever time such value is higher: (1) the first day on which action is taken by the organization which culminates in its ceasing to be a private foundation, or (2) the date on which it ceases to be a private foundation.

(f) *Liability in Case of Transfers of Assets From Private Foundation*—For purposes of deter-

mining liability for the tax imposed by subsection (c) in the case of assets transferred by the private foundation, such tax shall be deemed to have been imposed on the first day on which action is taken by the organization which culminates in its ceasing to be a private foundation.

(g) *Abatement of Taxes* — The Secretary may abate the unpaid portion of the assessment of any tax imposed by subsection (c), or any liability in respect thereof, if —

(1) the private foundation distributes all of its net assets to one or more organizations described in section 170(b)(1)(A) (other than in clauses (vii) and (viii)) each of which has been in existence and so described for a continuous period of at least 60 calendar months, or

(2) following the notification prescribed in section 6104(c) to the appropriate State officer, such State officer within one year notifies the Secretary in such manner as the Secretary may by regulations prescribe, that corrective action has been initiated pursuant to State law to insure that the assets of such private foundation are preserved for such charitable or other purposes specified in section 501(c)(3) as may be ordered or approved by a court of competent jurisdiction, and upon completion of the corrective action, the Secretary receives certification from the appropriate State officer that such action has resulted in such preservation of assets.

SEC. 4941. *Taxes On Self-Dealing.*

(a) *Initial Taxes.* —

(1) *On Self-Dealer* — There is hereby imposed a tax on each act of self-dealing between a disqualified person and a private foundation. The rate of tax shall be equal to 5 percent of the amount involved with respect to the act of self-dealing for each year (or part thereof) in the taxable period. The tax imposed by this paragraph shall be paid by any disqualified person (other than a foundation manager acting only as such) who participates in the act of self-dealing. In the case of a government official (as defined in section 4946(c)), a tax shall be imposed by this paragraph only if such disqualified person participates in the act of self-dealing knowing that it is such an act.

(2) *On Foundation Manager.* — In any case in which a tax is imposed by paragraph (1), there is hereby imposed on the participation of any foundation manager in an act of self-dealing between a disqualified person and a private foundation, knowing that it is such an act, a tax equal to 2½ percent of the amount involved with respect to the act of self-dealing for each year (or part thereof) in the taxable period, unless such participation is not willful and is due to reasonable cause. The tax imposed by this paragraph shall be paid by any foundation manager who participated in the act of self-dealing.

(b) *Additional Taxes.* —

(1) *On Self-Dealer.* — In any case in which an initial tax is imposed by subsection (a)(1) on an act of self-dealing by a disqualified person with a private foundation and the act is not corrected within the taxable period, there is hereby imposed a tax equal to 200 percent of the amount involved. The tax im-

posed by this paragraph shall be paid by any disqualified person (other than a foundation manager acting only as such) who participated in the act of self-dealing.

(2) *On Foundation Manager.* — In any case in which an additional tax is imposed by paragraph (1), if a foundation manager refused to agree to part or all of the correction, there is hereby imposed a tax equal to 50 percent of the amount involved. The tax imposed by this paragraph shall be paid by any foundation manager who refused to agree to part or all of the correction.

(c) *Special Rules.* — For purposes of subsections (a) and (b) —

(1) *Joint and Several Liability* — If more than one person is liable under any paragraph of subsection (a) or (b) with respect to any one act of self-dealing, all such persons shall be jointly and severally liable under such paragraph with respect to such act.

(2) *$10,000 Limit for Management.* — With respect to any one act of self-dealing, the maximum amount of the tax imposed by subsection (a)(2) shall not exceed $10,000, and the maximum amount of the tax imposed by subsection (b)(2) shall not exceed $10,000.

(d) *Self-Dealing.* —

(1) *In General.* — For purposes of this section, the term "self-dealing" means any direct or indirect —

(A) sale or exchange, or leasing, of property between a private foundation and a disqualified person;

(B) lending of money or other extension of credit between a private foundation and a disqualified person;

(C) furnishing of goods, services, or facilities between a private foundation and a disqualified person;

(D) payment of compensation (or payment or reimbursement of expenses) by a private foundation to a disqualified person;

(E) transfer to, or use by or for the benefit of, a disqualified person of the income or assets of a private foundation; and

(F) agreement by a private foundation to make any payment of money or other property to a government official (as defined in section 4946(c)), other than an agreement to employ such individual for any period after the termination of his government service if such individual is terminating his government service within a 90-day period.

(2) *Special Rules.*—For purposes of paragraph (1)—

(A) the transfer of real or personal property by a disqualified person to a private foundation shall be treated as a sale or exchange if the property is subject to a mortgage or similar lien which the foundation assumes or if it is subject to a mortgage or similar lien which a disqualified person placed on the property within the 10-year period ending on the date of the transfer;

(B) the lending of money by a disqualified person to a private foundation shall not be an act of self-dealing if the loan is without in-

terest or other charge and if the proceeds of the loan are used exclusively for purposes specified in section 501 (c) (3);

(C) the furnishing of goods, services, or facilities by a disqualified person to a private foundation shall not be an act of self-dealing if furnishing is without charge and if the goods, services or facilities so furnished are used exclusively for purposes specified in section 501 (c) (3);

(D) the furnishing of goods, services, or facilities by a private foundation to a disqualified person shall not be an act of self-dealing if such furnishing is made on a basis no more favorable than that on which such goods, services, or facilities are made available to the general public;

(E) except in the case of a government official (as defined in section 4946 (c)), the payment of compensation (and the payment or reimbursement of expenses) by a private foundation to a disqualified person for personal services which are reasonable and necessary to carrying out the exempt purpose of the private foundation shall not be an act of self-dealing if the compensation (or payment or reimbursement) is not excessive;

(F) any transaction between a private foundation and a corporation which is a disqualified person (as defined in section 4946 (a), pursuant to any liquidation, merger, redemption, recapitalization, or other corporate adjustment, organization, or reorganization, shall not be an act of self-dealing if all of the securities of the same class as that held by the foundation are subject to the same terms and such terms provide for receipt by the foundation of no less than fair market value;

(G) in the case of a government official (as defined in section 4946 (c)), paragraph (1) shall in addition not apply to—

(i) prizes and awards which are subject to the provisions of section 74 (b), if the recipients of such prizes and awards are selected from the general public,

(ii) scholarships and fellowship grants which are subject to the provisions of section 117 (a) and are to be used for study at an educational organization described in section 170 (b) (1) (A) (ii),

(iii) any annuity or other payment (forming part of a stock bonus, pension, or profit-sharing plan) by a trust which is a qualified trust under section 401,

(iv) any annuity or other payment under a plan which meets the requirements of section 404 (a) (2),

(v) any contribution or gift (other than a contribution or gift of money) to, or services or facilities made available to, any such individual, if the aggregate value of such contributions, gifts, services, and facilities to, or made available to, such individual during any calendar year does not exceed $25,

(vi) any payment made under chapter 41 of title 5, United States Code, or

(vii) any payment or reimbursement of traveling expenses for travel solely from one point in the United States to another point in the United States, but only if such payment or reimbursement does not exceed the actual cost of the transportation involved plus an amount for all other traveling expenses not in excess of 125 percent of the maximum amount payable under section 5702 (a) of title 5, United States Code, for like travel by employees of the United States; and

(H) the leasing by a disqualified person to a private foundation of office space for use by the foundation in a building with other tenants who are not disqualified persons shall not be treated as an act of self-dealing if—

(i) such leasing of office space is pursuant to a binding lease which was in effect on October 9, 1969, or pursuant to renewals of such a lease;

(ii) the execution of such lease was not a prohibited transaction (within the meaning of section 503 (b) or any corresponding provision of prior law) at the time of such execution; and

(iii) the terms of the lease (or any renewal) reflect an arm's length transaction.

(e) *Other Definitions.*—For purposes of this section—

(1) *Taxable Period.*—The term "taxable period" means, with respect to any act of self-dealing, the period

beginning with the date on which the act of self-dealing occurs and ending on the earliest of—

(A) the date of mailing a notice of deficiency with respect to the tax imposed by subsection (a) (1) under section 6212,

(B) the date of which the tax imposed by subsection (a) (1) is assessed, or

(C) the date on which correction of the act of self-dealing is completed.

(2) *Amount Involved.*—The term "amount involved" means, with respect to any act of self-dealing, the greater of the amount of money and the fair market value of the other property given or the amount of money and the fair market value of the other property received; except that, in the case of services described in subsection (d) (2) (E), the amount involved shall be only the excess compensation. For purposes of the preceding sentence, the fair market value—

(A) in the case of the taxes imposed by subsection (a), shall be determined as of the date on which the act of self-dealing occurs; and

(B) in the case of the taxes imposed by subsection (b), shall be the highest fair market value during the taxable period.

(3) *Correction.*—The terms "correction" and "correct" mean, with respect to any act of self-dealing, undoing the transaction to the extent possible, but in any case placing the private foundation in a financial position not worse than that in which it would be if the disqualified person were dealing under the highest fiduciary standards.

SEC. 4946. *Definitions and Special Rules.*

(a) *Disqualified Person.*—

(1) *In General.*—For purposes of this subchapter, the term "disqualified person" means, with respect to a private foundation, a person who is—

(A) a substantial contributor to the foundation,

(B) a foundation manager (within the meaning of section (b) (1)),

(C) an owner of more than 20 percent of—

(i) the total combined voting power of a corporation,

(ii) the profits interest of a partnership, or

(iii) the beneficial interest of a trust or unincorporated enterprise, which is a substantial contributor to the foundation

(D) a member of the family (as defined in subsection (d)) of any individual described in subparagraph (A), (B), or (C),

(E) a corporation of which persons described in subparagraph (A), (B), (C), or (D) own more than 35 percent of the total combined voting power,

(F) a partnership in which persons described in subparagraph (A), (B), (C), or (D) own more than 35 percent of the profits interest,

(G) a trust or estate in which persons described in subparagraph (A), (B), (C), or (D) hold more than 35 percent of the beneficial interest,

(H) only for purposes of section 4943, a private foundation—

(i) which is effectively controlled (directly or indirectly) by the same person or persons who control the private foundation in question, or

(ii) substantially all of the contributions to which were made (directly or indirectly) by the same person or persons described in subparagraph (A), (B), or (C), or members of their families (within the meaning of subsection (d)), who made (directly or indirectly) substantially all of the contributions to the private foundation in question, and

(I) only for purposes of section 4941, a government official (as defined in subsection (c)).

(2) *Substantial Contributors.*—For purposes of paragraph (1), the term "substantial contributor" means a person who is described in section 507 (d) (2).

(3) *Stockholdings.*—For purposes of paragraphs (1) (C) (i) and (1) (E), there shall be taken into account indirect stockholdings which would be taken into account under section 267(c), except that, for purposes of this paragraph, section 267 (c) (4) shall be treated as providing that the members of the family of an individual are the members within the meaning of subsection (d).

(4) *Partnerships; Trusts.* For purposes of paragraphs (1) (C) (ii) and (iii), (1) (F), and (1) (G), the ownership

of profits or beneficial interests shall be determined in accordance with the rules for constructive ownership of stock provided in section 267 (c) (other than paragraph (3) thereof), except that section 267 (c) (4) shall be treated as providing that the members of the family of an individual are the members within the meaning of subsection (d).

(b) *Foundation Manager.* — For purposes of this subchapter, the term "foundation manager" means, with respect to any private foundation —

(1) an officer, director, or trustee of a foundation (or an individual having powers or responsibilities similar to those of officers, directors, or trustees of the foundation), and

(2) with respect to any act (or any failure to act), the employees of the foundation having authority or responsibility with respect to such act (or failure to act).

(c) *Government Official.* — For purposes of subsection (a) (1) (I) and section 4941, the term "government official" means, with respect to an act of self-dealing described in section 4941, an individual who, at the time of such act, holds any of the following offices or positions (other than as a "special Government employee", as defined in section 202(a) of title 18, United States Code):

(1) an elective public office in the executive or legislative branch of the Government of the United States,

(2) an office in the executive or judicial branch of the Government of the United States, appointment to which was made by the President,

(3) a position in the executive, legislative, or judicial branch of the Government of the United States—

(A) which is listed in schedule C of rule VI of the Civil Service Rules, or

(B) the compensation for which is equal to or greater than the lowest rate of compensation prescribed for GS-16 of the General Schedule under section 5332 of title 5, United States Code,

(4) a position under the House of Representatives or the Senate of the United States held by an individual receiving gross compensation at an annual rate of $15,000 or more,

(5) an elective or appointive public office in the executive, legislative or judicial branch of the government of a State, possession of the United States, or political subdivision or other area of any of the foregoing, or of the District of Columbia, held by an individual receiving gross compensation at an annual rate of $15,000 or more, or

(6) a position as personal or executive assistant or secretary to any of the foregoing.

(d) *Members of Family.*—For purposes of subsection (a)(1), the family of any individual shall include only his spouse, ancestors, lineal descendants, and spouses of lineal descendants.

Treasury Regulations (1954 Code) (26 C.F.R.):

§ 53.4941(d)-1. *Definition of Self-Dealing.* —

. . . .

(b) *Indirect self-dealing* —

. . . .

(3) *Transactions during the administration of an estate or revocable trust.* The term "indirect self-dealing" shall not include a transaction with respect to a private foundation's interest or expectancy in property (whether or not encumbered) held by an estate (or revocable trust, including a trust which has become irrevocable on a grantor's death), regardless of when title to the property vests under local law, if—

(i) The administrator or executor of an estate or trustee of a revocable trust either—

(a) Possesses a power of sale with respect to the property,

(b) Has the power to reallocate the property to another beneficiary, or

(c) Is required to sell the property under the terms of any option subject to which the property was acquired by the estate (or revocable trust);

(ii) Such transaction is approved by the probate court having jurisdiction over the estate (or by another court having jurisdiction over the estate (or trust) or over the private foundation);

(iii) Such transaction occurs before the estate is considered terminated for Federal income tax purposes pursuant to paragraph (a) of § 1.641(b)-3 of this chapter (or in the case of a revocable trust, before it is considered subject to section 4947);

(iv) The estate (or trust) receives an amount which equals or exceeds the fair market value of the foundation's interest or expectancy in such property at the time of the transaction, taking into account the terms of any option subject to which the property was acquired by the estate (or trust); and

(v) With respect to transactions occurring after April 16, 1973, the transaction either—

(a) Results in the foundation receiving an interest or expectancy at least as liquid as the one it gave up,

(b) Results in the foundation receiving an asset related to the active carrying out of its exempt purposes, or

(c) Is required under the terms of any option which is binding on the estate (or trust).